

Sir Winfried Bischoff
Chairman

Baroness Neville-Rolfe DBE CMG
Parliamentary Under Secretary of State
Department for Business, Innovation and Skills
1 Victoria Street
London SW1H 0ET

BY POST

Dear Minister,

IMPLEMENTATION OF THE AUDIT REGULATION AND DIRECTIVE

I am writing to draw to your attention the FRC's views on the consultation document and draft Regulations for implementing the EU audit reforms in the UK, which the Department published in October.

We welcome the Government's proposals to designate the FRC as the competent authority for audit and with direct responsibility for regulating the audits of public interest entities (PIEs). We also support the FRC delegating the task of regulating non-PIE audits to recognised professional bodies, subject to setting conditions and ongoing oversight, in line with your earlier Ministerial Statement. Both the FRC and the professional bodies have a major role in achieving high quality audit work in the UK. The legislation establishes the appropriate broad balance between regulation that should be undertaken entirely independently of the profession, and regulation that can be undertaken by the professional bodies. We are also pleased that the draft legislation provides a firm basis for the FRC to set the necessary auditing and ethical standards in its own right.

We are pleased to have had the opportunity to discuss the proposals in detail with your officials and with the professional bodies during the consultation period. That process is continuing and we hope is helping to improve the draft legislation so that it not only meets the EU requirements but also provides a framework that:

- is clear and sustainable with clear lines of accountability, such that companies and audit firms know the precise role of all the UK regulatory bodies;
- supports market confidence in the independence of regulation, so that investors and potential investors remain confident in the quality of financial statements;
- provides for proportionate implementation that can be justified and defended; and
- serves the public interest.

That said, we still have significant concerns about whether the draft Statutory Instrument and Secretary of State Direction as published meet these principles in relation to the responsibilities and powers of the FRC as the competent authority. These concerns are set out below.

Designation of the FRC as the Competent Authority (CA)

The draft SI incorrectly describes the CA's role in Regulation 3 as to "oversee" rather than to have responsibility for the regulatory tasks (and then to delegate the operation of the tasks whilst retaining the oversight). It also omits to designate the CA, as required by the EU measures, as the body directly responsible for (at least) the regulation of all audits of public interest entities; as having overall responsibility for the public oversight system; and as the body with overall responsibility for approving statutory auditors and audit firms in the UK. Without these designations both the role of the CA and the basis of its delegations to the bodies is legally and practically unsound.

Delegation of tasks by the Competent Authority to the professional bodies

Whilst we are generally content with the arrangements under which the FRC will delegate regulatory tasks to the professional bodies, greater clarity is needed in the implementing legislation and the Secretary of State Direction as to the circumstances in which it would be appropriate for the FRC not to delegate a task or in which the FRC is able to reclaim a task that has been delegated. For example, we believe that the FRC should be able to include within the scope of its inspections (and so not delegate) a defined group of audits of non-PIEs which are typically of greater economic significance and public interest than the audits of smaller companies listed on the main market e.g. large AIM companies with a market capitalization of in excess of £100m. The FRC currently inspects this group of audits on the basis that they are "major audits". At present the proposals only allow for this if the FRC considers the body is unable to carry out the task or with the agreement of the body. Further, the Directive requires the CA to be able to reclaim "competences" on a case by case basis and we do not think that the provisions as drafted, under which the FRC could only reclaim competences back in narrow circumstances, meet the EU requirements.

Enforcement and Appeals

The Directive makes clear that the sanctions listed (and which are reflected in the SI) are the minimum sanctions that must be available. However, the draft SI implements them as maximum sanctions. The effect of this is to remove from our administrative disciplinary systems the more proportionate sanctions that we currently have and leave only the most punitive. For example the new list does not include the ability to set conditions on the registration of auditors and audit firms such as training requirements or other sanctions designed to bring about an improvement in the quality of audit and/or the avoidance of future shortcomings. It is also not logical that the range of sanctions against auditors available to the CA would be narrower than those that the professional body could apply under delegated arrangements.

Register of Auditors

As drafted, the SI delegates the keeping of the register of statutory auditors to a 'maintaining body' (i.e. not the CA) but provides for the CA to "reclaim" that function. This contradicts the Directive requirement for the CA to have responsibility for this task; needlessly complicates the structure; and is unworkable given that the CA cannot "reclaim" a function for which it has no primary responsibility.

Enforcement against directors of PIEs

The Audit Regulation and Directive place a number of responsibilities on PIEs and their directors, and on the CA for enforcing those responsibilities. PIEs include UK companies listed on the main market, unlisted banks and unlisted insurers; entities of economic significance. Whilst there has been initial discussion with your officials and other regulators on the scope for collaborative working, it is important that there is clarity in the legislation and in any arrangements on the scope of the FRC's new responsibilities in this area. We need to know more precisely what is expected by the Government.

Yours sincerely
Lin Burnett